BANCA ALETTI
GRUPPO BANCO POPOLARE

Global Economy Report

October 2014

European University Institute

ROBERT SCHUMAN CENTRE FOR ADVANCED STUDIES

GLOBAL GOVERNANCE Programme

Global Economy Report

The Global Economy Report is prepared in cooperation by the Macroeconomic Research Division of Banca Aletti and the Global Governance Programme of the Robert Schuman Centre for Advanced Studies of the European University Institute.

The objective of the Report is to provide an analysis of the current and expected macroeconomic and financial conditions at the global level, with also a focus on key economic areas such as Europe, the USA and ASIA.

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EXECUTIVE SUMMARY

- In the October World Economic Outlook, IMF further cut its global growth forecasts. New forecasts are at 3.3% for 2014, at 3.8% in 2015 and at 4% in 2016.

- Two main factors account for the reduction in growth forecasts: (a) the depressive effects of the 2007/2008 crisis are more persistent than supposed, also given the efforts to neutralise these effects; (b) the entire system's growth potential declined, thus growth's evolution will be more limited, impacting on business and households' confidence and on demand, with circular effects that feed each other.

- For 2014, IMF forecasts growth in major economies at 1.8% and at 4.4% for emerging markets. Corresponding values in 2015 are at 2.3% and 5% respectively.

EXECUTIVE SUMMARY

- In Q2, the US economy grew above expectations, thus confirming Q1's weakness was a one-off, due to adverse weather conditions. GDP increased by 4.6% in annual terms, thanks to a strong take off of consumption of durable goods and investments. Growth forecasts for Q3 have been revised upwards, from 2.5% to 3.5% annualised.

- Average growth rate expected for 2014 is at 2.2%, up two tenths on the previous forecast, due to robust performance in Q2 and the recent flow of data above forecasts. For 2015 we assume a consolidation at 3.0%.

- Inflation fell to 1.7%, confirming an evolution under control. For 2014 we expect an overall rate of 1.8%, growing slightly in 2015 to 2%.

EXECUTIVE SUMMARY

- ❖ In the Euro area recovery is at risk. In October, leading indicators increased their downward trajectory in a generalised manner. In particular, the German economy is worrisome.

- ❖ We confirm a scenario of modest recovery, but with intensity below expectations and under growing risks due to the Ukraine crisis and Italy's problematic economic conditions. We thus confirm our growth estimate at 0.8% in 2014 and 1.1% in 2015, already trimmed last month.

- ❖ Aggregate inflation is at +0.3% in September, kept particularly low by energy prices; core inflation is at 0.8% in the final data, up from previous 0.7%. Retail prices remain weak; for the long term we expect low inflation, but not a structural and systematic drop in prices. Average inflation rate estimate is at 0.6% in 2014 and +1.0% in 2015.

- ❖ In this report we focus on the euro area outlook.

EXECUTIVE SUMMARY

❖ Relatively to big emerging markets, IMF again cut growth forecasts significantly for Brazil, Russia and South Africa. Brazil should remain flat this year (0.3%) and accelerate only by 1.4% next year. Russia's growth projection was lowered by half a point, with a minimal growth at 0.2% in 2014 and at 0.5% in 2015. South Africa was reduced by seven tenths, with this year's growth at 1.4% and at 2.3% in 2015.

❖ China's GDP forecast is confirmed at 7.4% this year and at 7.1% next, while India is one of the few with an upward revision at 5.6% (up two tenths), confirming 2015 projection at 6.4%.

EXECUTIVE SUMMARY

	2009	2010	2011	2012	2013E	2014E	2015E
GDP (%YOY)							
US	-2.8	2.6	1.6	2.3	2.2	**2.2**	**3.0**
EUROZONE	-4.4	2.0	1.4	-0.6	-0.4	**0.8**	**1.2**
GERMANY	-5.1	4.2	3.0	0.7	0.4	**1.5**	**1.6**
FRANCE	-3.1	1.7	2.0	0.0	0.4	**0.4**	**1.0**
ITALY	-5.5	1.8	0.4	-2.4	-1.8	**-0.2**	**0.7**
UK	-5.1	1.7	1.1	0.1	1.7	**3.1**	**2.8**
JAPAN	-5.5	4.7	-0.6	2.0	1.5	**0.9**	**1.1**
BRASIL	-0.3	7.6	2.8	1.0	2.3	**0.3**	**1.3**
RUSSIA	-7.8	4.3	4.3	3.4	1.3	**0.3**	**1.0**
INDIA	6.4	8.9	7.5	5.1	4.6	**5.5**	**6.2**
CHINA	9.2	10.4	9.3	7.7	7.7	**7.3**	**7.0**
AUSTRALIA	1.4	2.6	1.4	3.6	2.4	**3.0**	**2.9**
KOREA	0.3	6.3	3.6	2.0	2.8	**3.6**	**3.8**
INFLATION (%YOY)							
US	-0.4	1.6	3.2	2.1	1.5	**1.8**	**2.0**
EUROZONE	0.3	1.6	2.7	2.5	1.4	**0.6**	**1.1**
GERMANY	0.2	1.2	2.5	2.1	1.6	**1.0**	**1.5**
FRANCE	0.1	1.7	2.3	2.2	1.0	**0.7**	**1.0**
ITALY	0.8	1.6	2.9	3.3	1.3	**0.3**	**0.6**
UK	2.2	3.3	4.5	2.8	2.6	**1.7**	**1.8**
JAPAN	-1.3	-0.7	-0.3	0.0	0.4	**2.9**	**1.8**
BRASIL	4.9	5.0	6.6	5.4	6.2	**6.3**	**6.3**
RUSSIA	11.7	6.9	8.5	5.1	6.8	**7.3**	**6.6**
INDIA	10.8	12.1	8.9	10.4	10.9	**6.0**	**5.8**
CHINA	-0.7	3.3	5.4	2.7	2.6	**2.3**	**2.8**
AUSTRALIA	1.8	2.9	3.3	1.8	2.4	**2.6**	**2.5**
KOREA	2.8	3.0	4.0	2.2	1.3	**1.6**	**2.3**

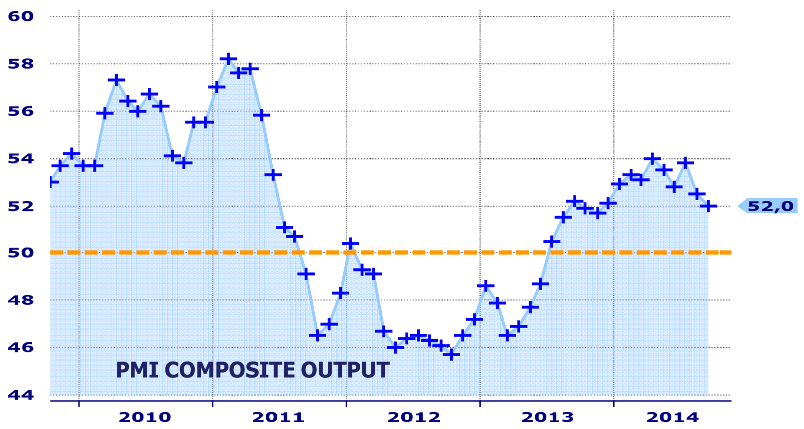
Banca Aletti Forecast

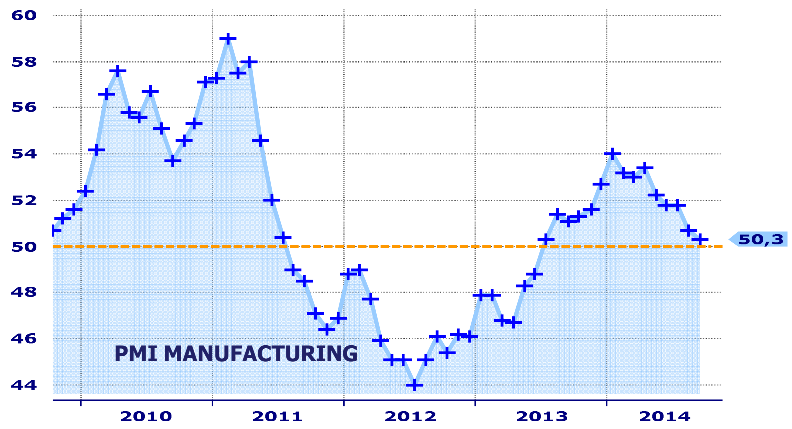
Cons. Bloomberg (Ott 14)

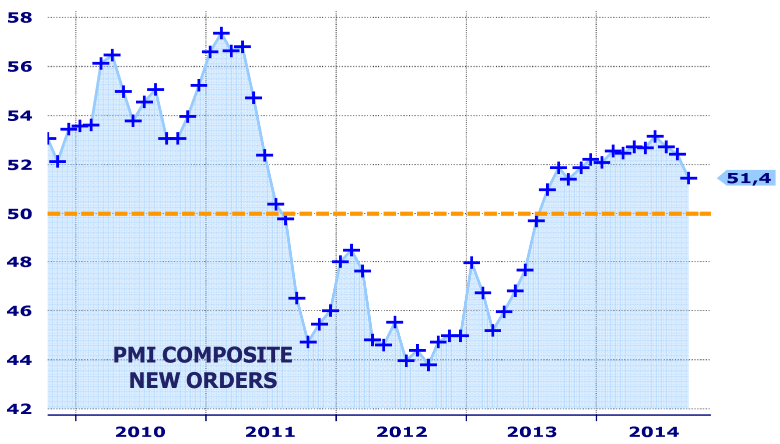
The Euro Area Outlook

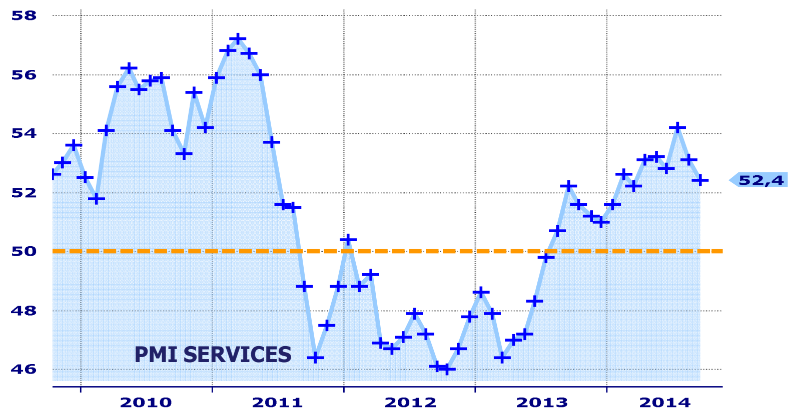
QUALITATIVE INDEXES – PMI EUROZONE

Eurozone's economy grew in September at the slowest pace of the year, reflecting a progressively decreasing demand. Composite PMI is down at 52, lowest in 10 months, while new orders component (51.4) is at end of 2013 levels. The survey certifies a conspicuous slowdown of the Union's economy, but it remains compatible with moderately positive aggregate income growth rates, thus remaining in the expansion area for the 15th consecutive month.



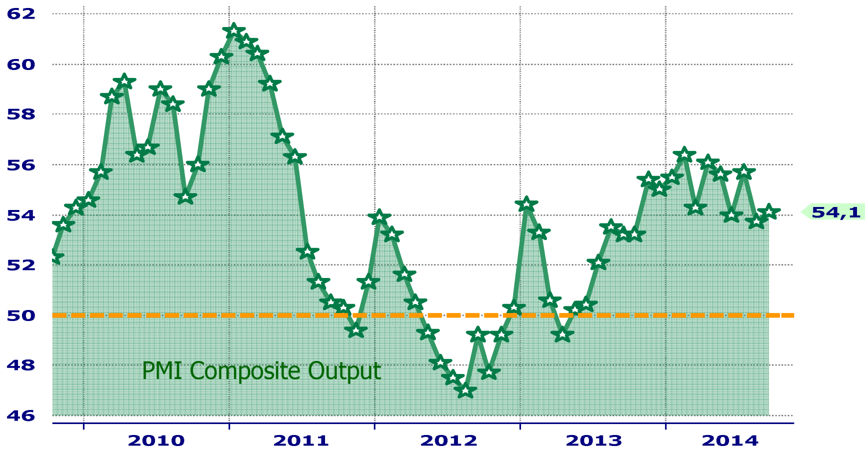


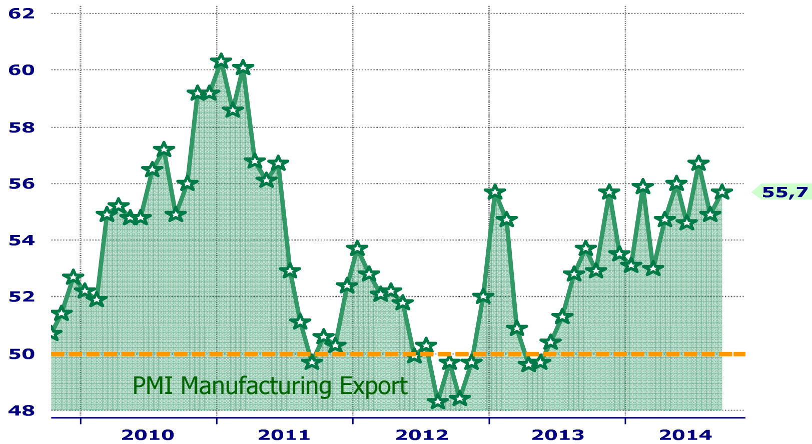


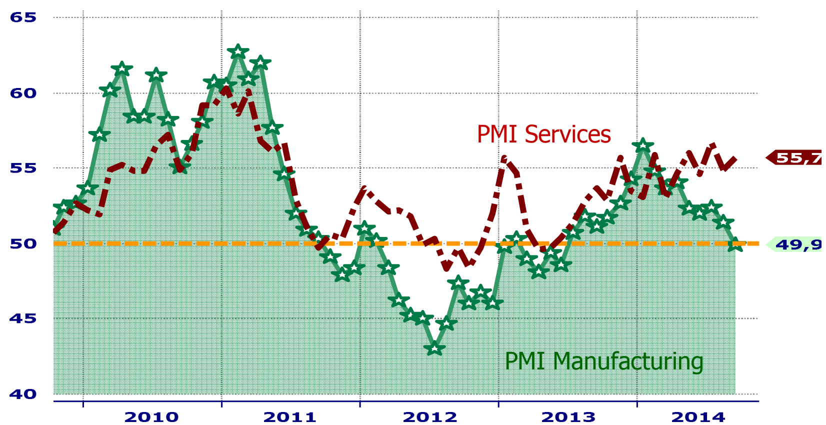


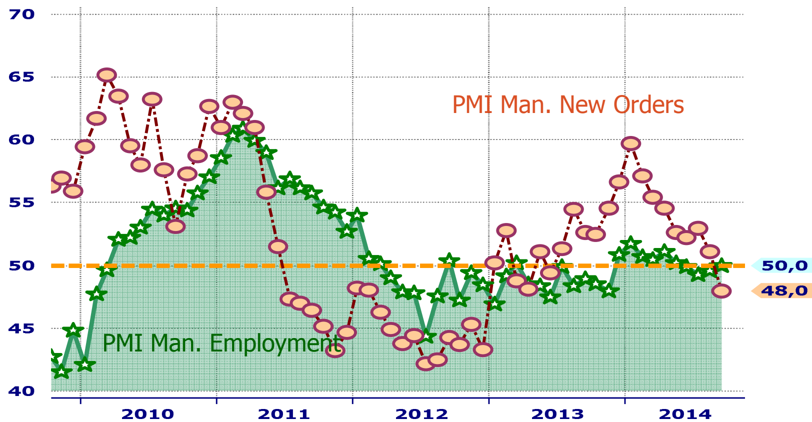
QUALITATIVE INDEXES – PMI GERMANY

Germany's private sector grew for the 17th month in a row in September, but at the slowest pace in 2014. The Composite PMI is at 54.1 points, slightly up from August's 53.7. The survey signals that Europe's slow down has hit Germany, whose industrial production is in a recession.





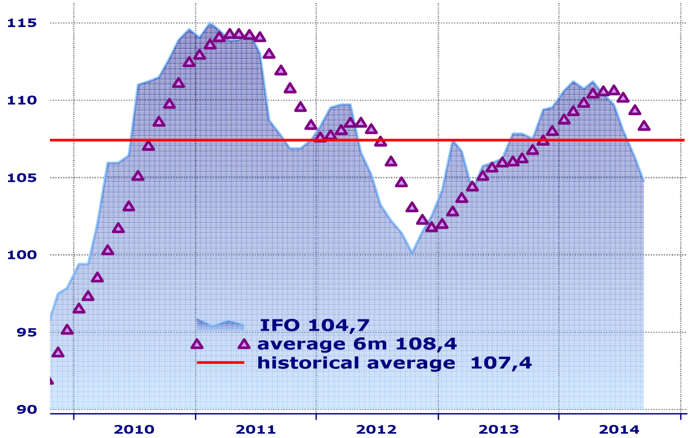




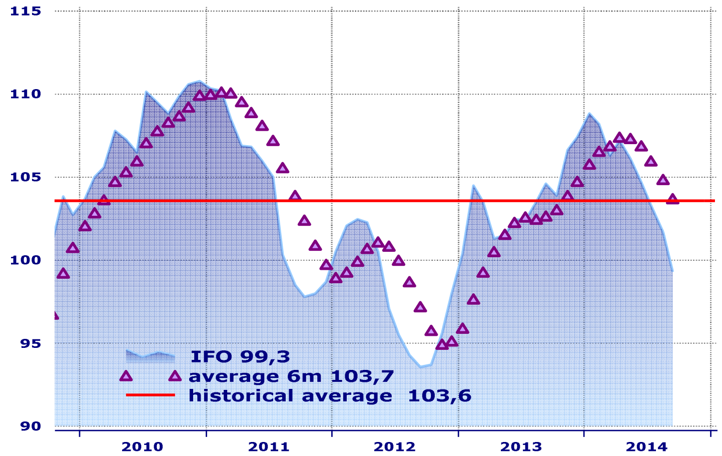
QUALITATIVE INDEXES – IFO GERMANY

September's IFO survey confirms Germany's signals of slowing down. In particular, expectations index hit lowest point since the end of 2012, completing a downward inversion that causes worries for recovery.

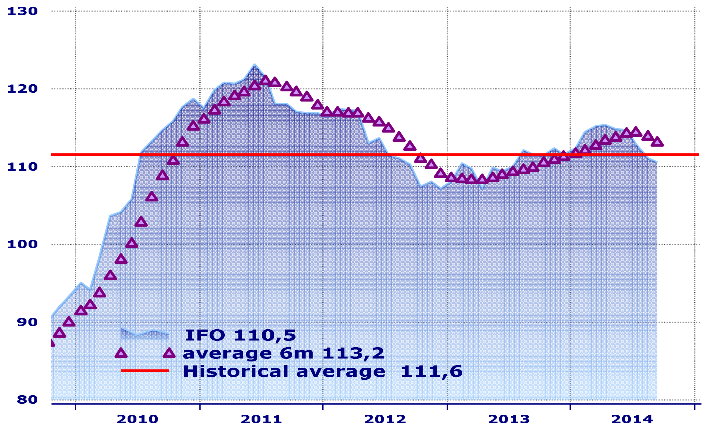
IFO – GENERAL INDEX



IFO – EXPECTATIONS

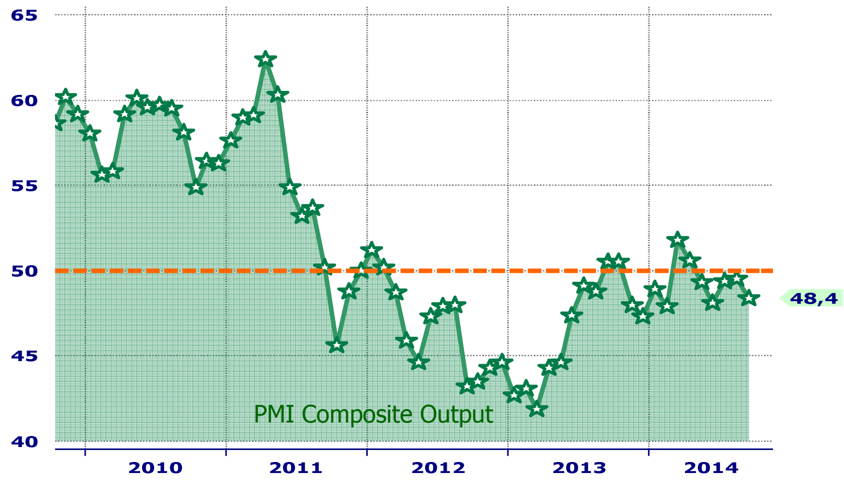


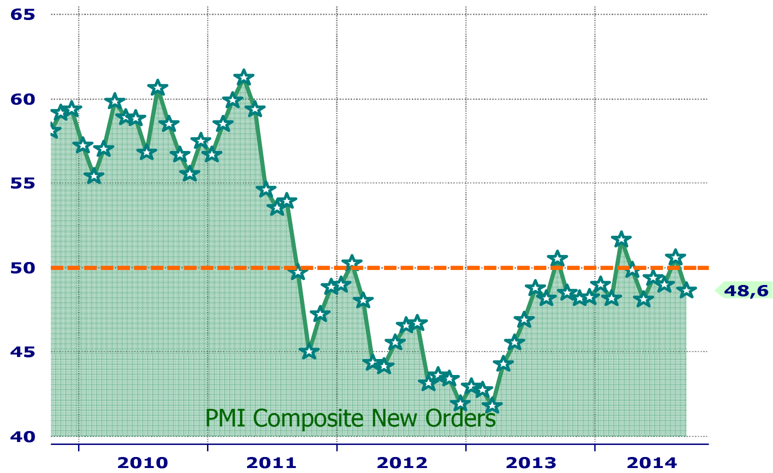
IFO – CURRENT CONDITIONS

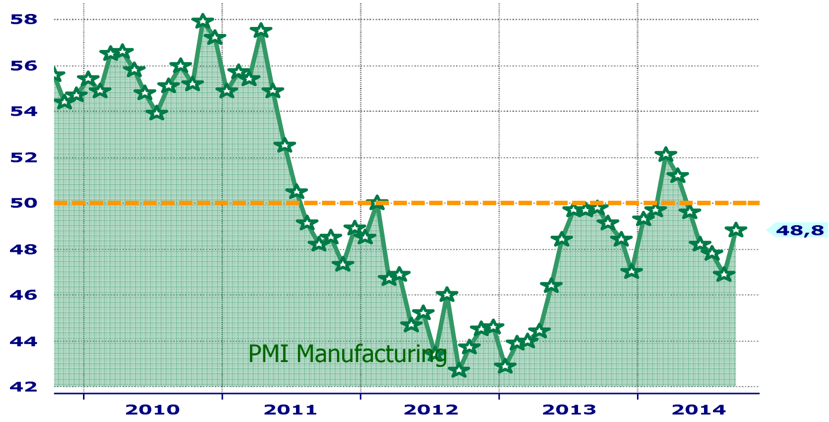


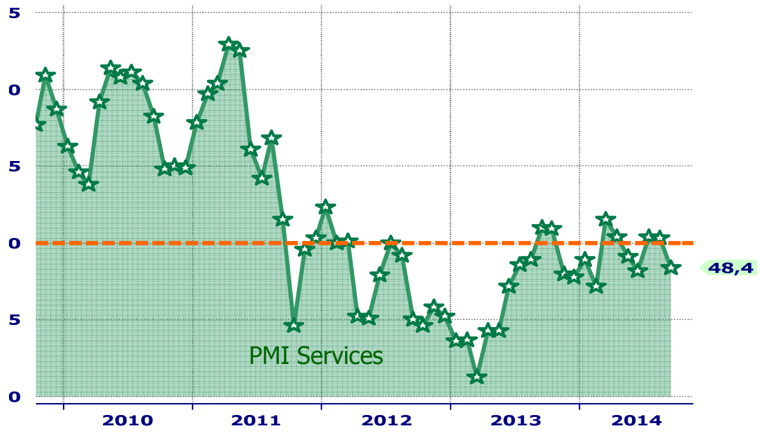
QUALITATIVE INDEXES – PMI FRANCE

The French private sector in September confirmed its contraction for the fifth consecutive month. Composite PMI index is at 48.4, signalling a risk of GDP decrease in Q3. Recessive conditions are present in services (48.4) and manufacturing (48.8). At 48.6, the New Orders component projects weakness also on the fourth quarter of the year.



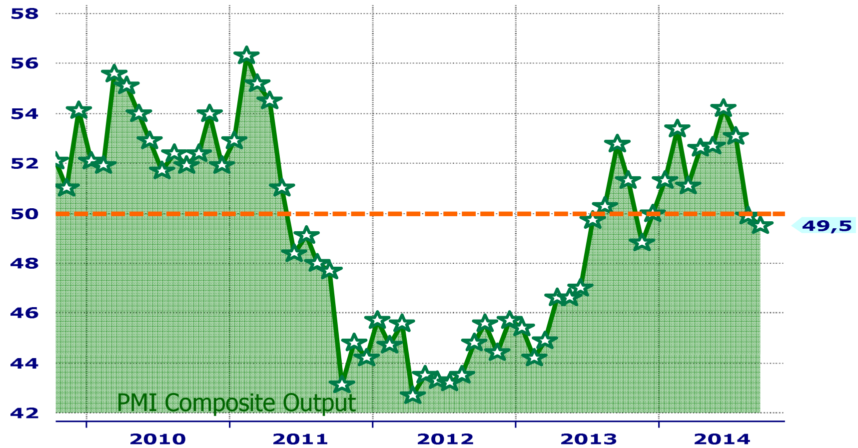


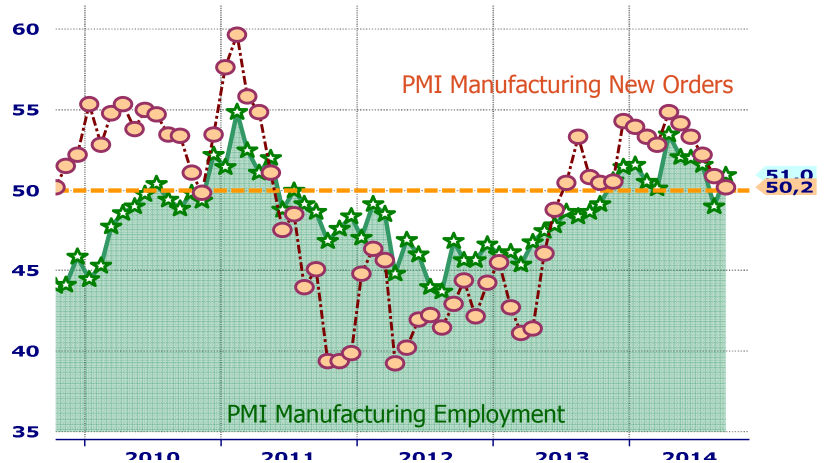


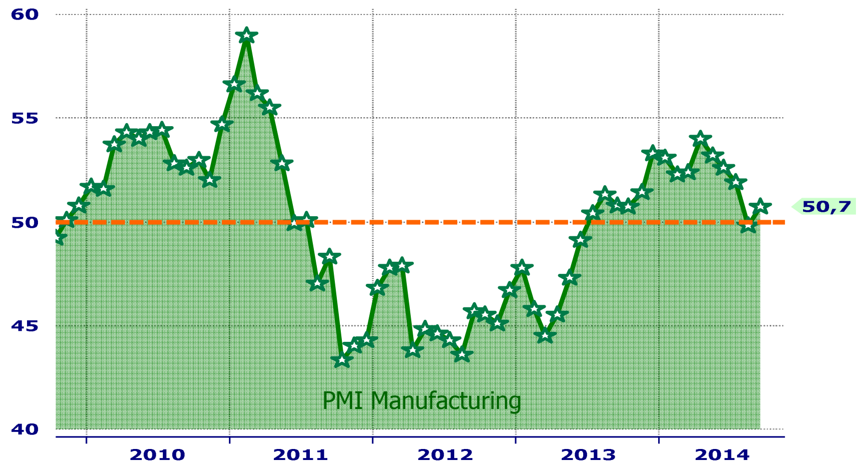


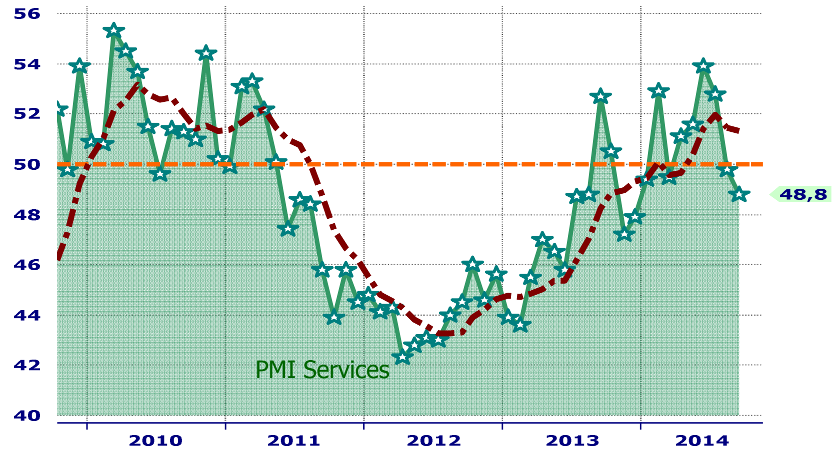
QUALITATIVE INDEXES – PMI ITALY

September survey signals a return to fully recessive conditions for the Italian economy. Composite PMI index dropped to 49.5, at a 10 month low. The economic climate is particularly bad in services (48.8, 9 month low), increasing marginally in manufacturing.



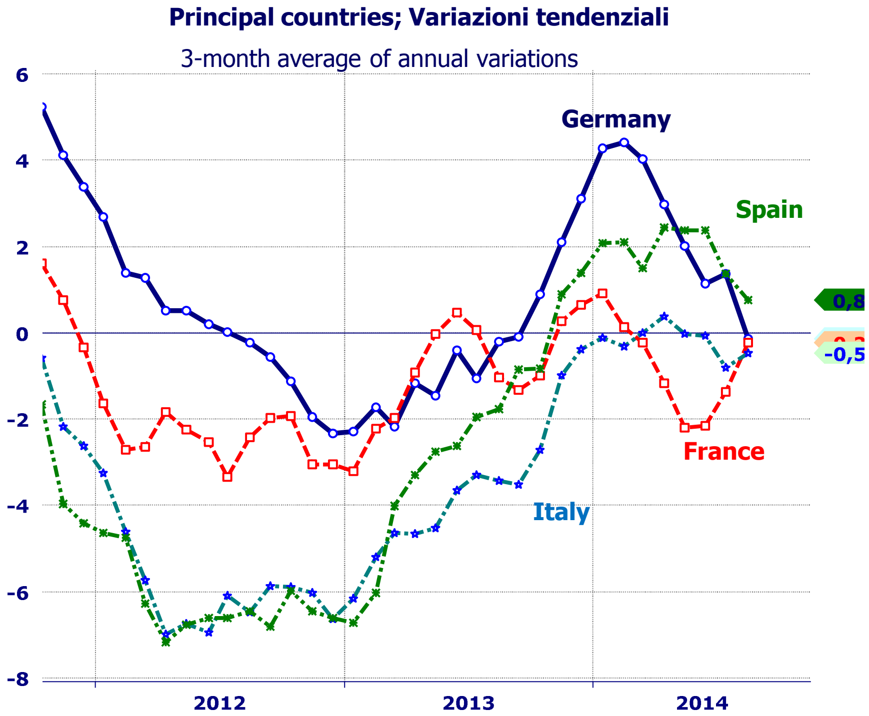


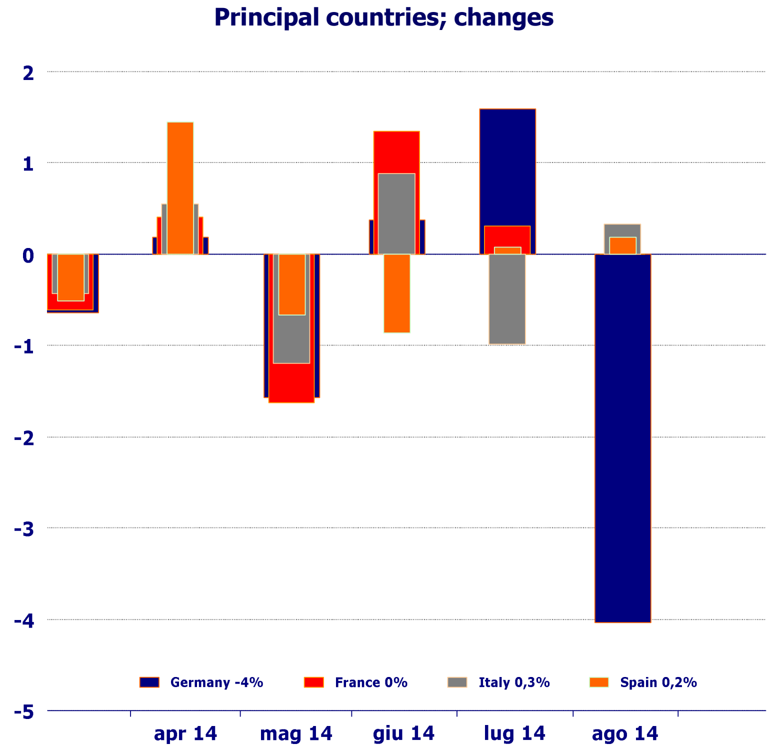




PRODUCTION

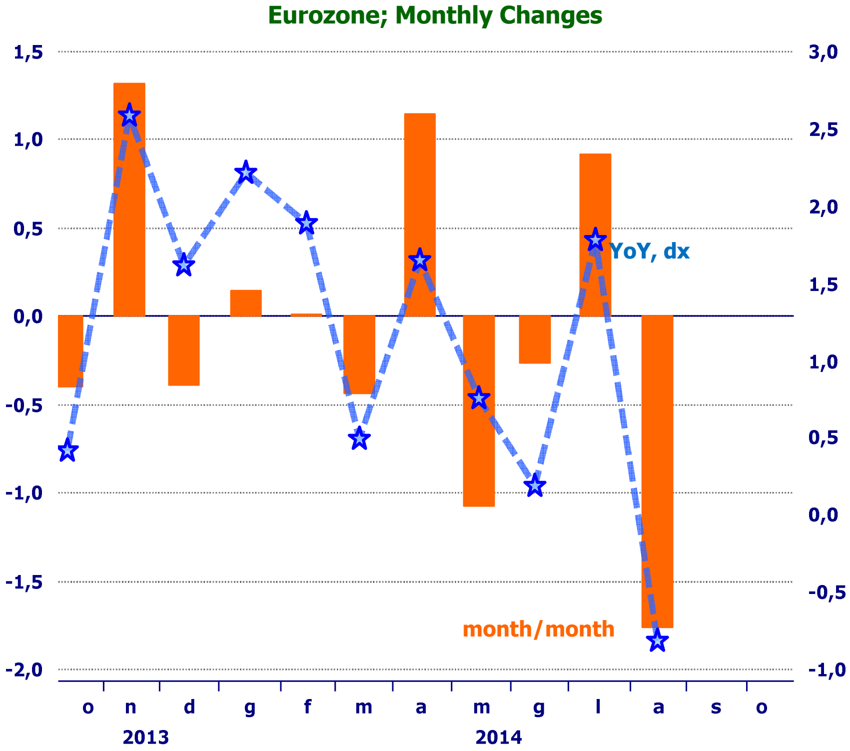
Germany's industrial production fell by 4% in August, registering the worst survey since 2009. On an annual basis, production growth returned negative for the first time since mid 2013. The presence of three conditions signal stagnation risk for Germany in Q3 and project strong doubts also on Q4: 1) decrease in industrial activity; 2) manufacturing PMI under 50; 3) IFO expectations index at lowest since end of 2012.

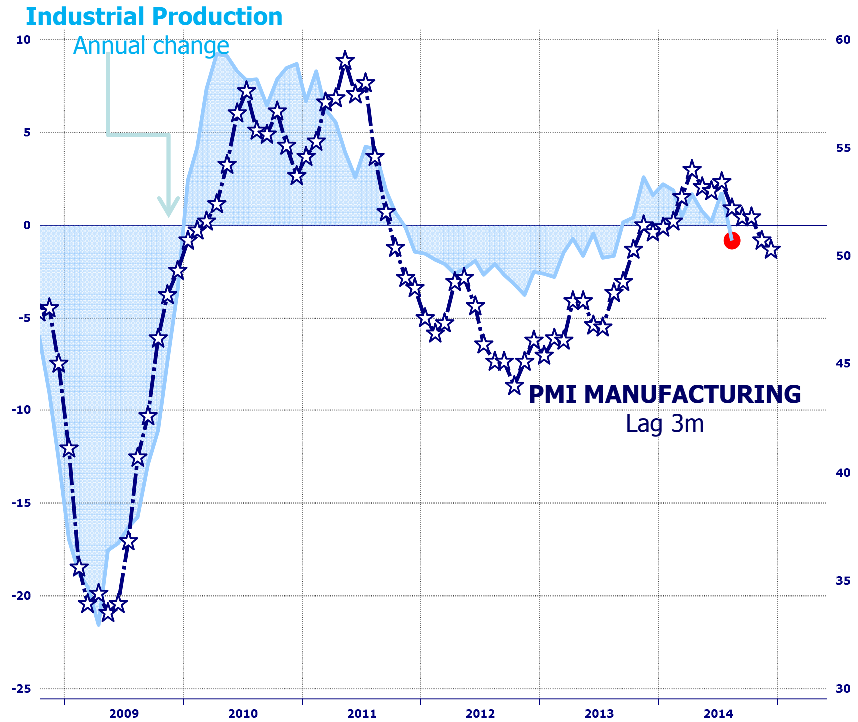




PRODUCTION

The strong reduction in Germany's production has slowed down the whole Eurozone economy, whose industrial activity decreased by slightly less than two percentage points, enough to bring trend growth rate in negative territory. The leading indicator projects weakness also on Q4.

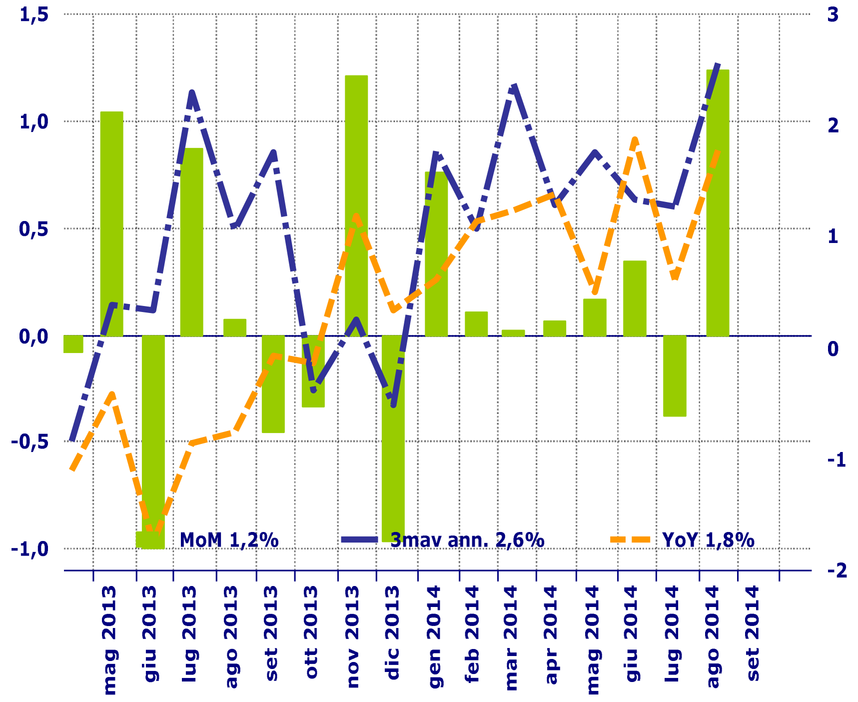




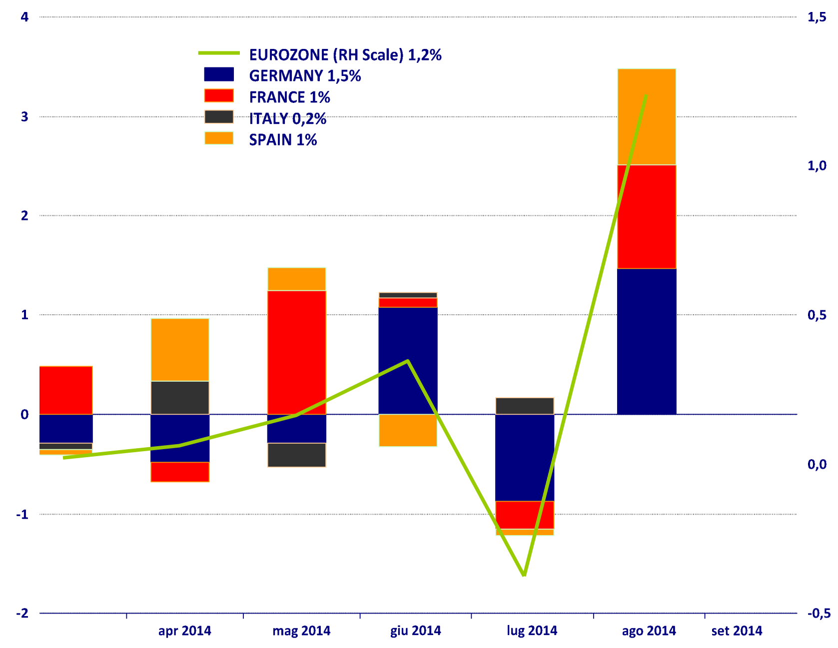
RETAIL SALES

After July's contraction, retail sales signalled an unexpected rebound in August, with aggregate data up 1.2%, much higher than consensus forecasts. This data reflects simultaneous acceleration of domestic spending in Germany, France and Spain and helps balance weakness in industrial activity. We maintain our forecast for a modest growth in the summer months…

RETAIL SALES
Eurozone; changes



VARIAZIONI CONGIUNTURALI
Principal countries, changes

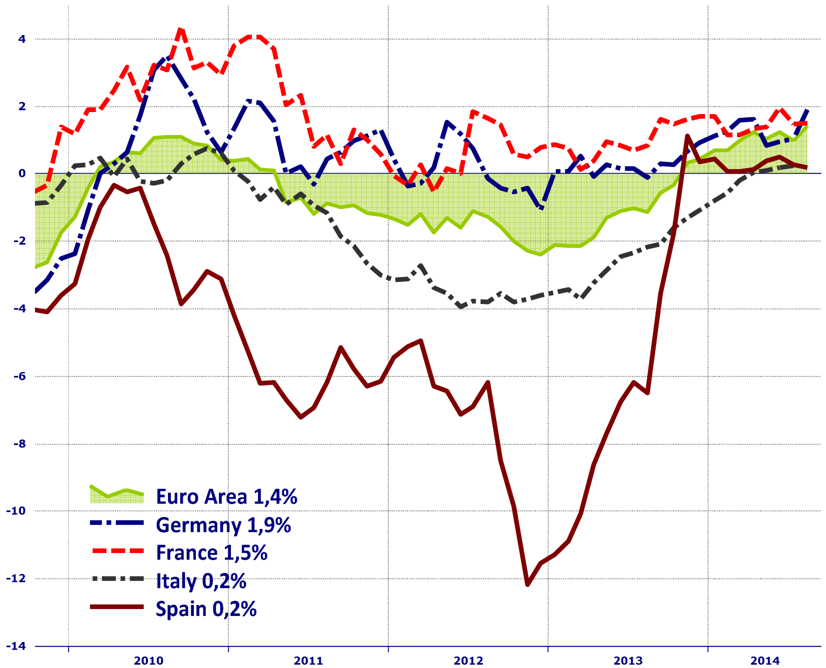


RETAIL SALES

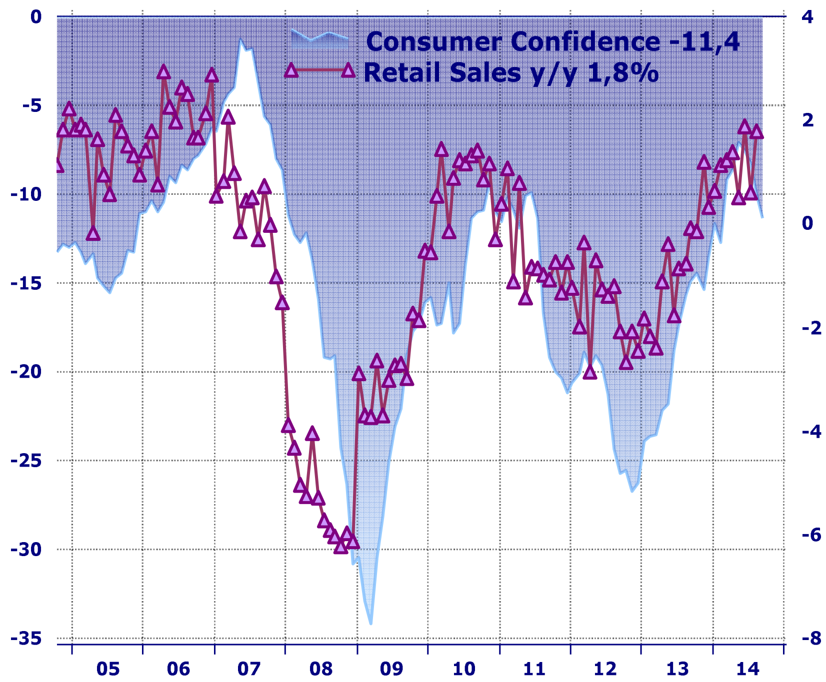
Retail sales' growth rate is positive in all Eurozone's major economies. Aggregate data is close to 2007 highs.

CHANGES

Principal countries; changes annualised

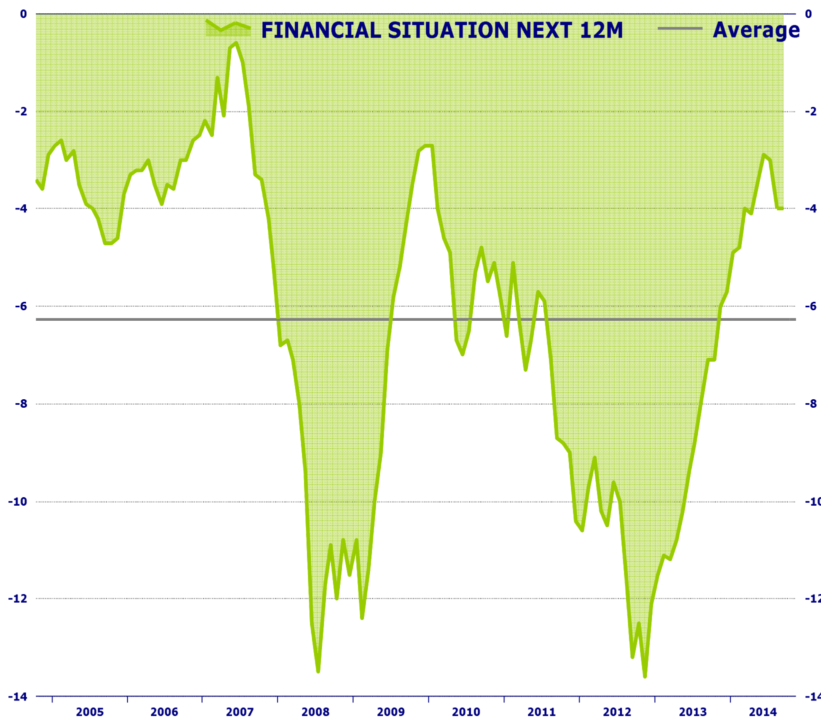


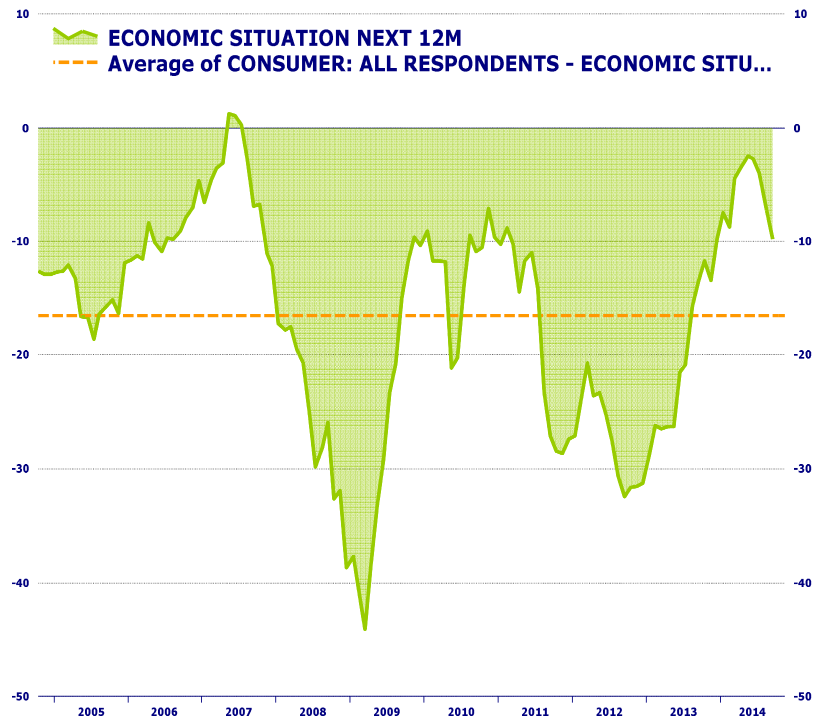
COMPARATIVE LEVELS



CONSUMPTION

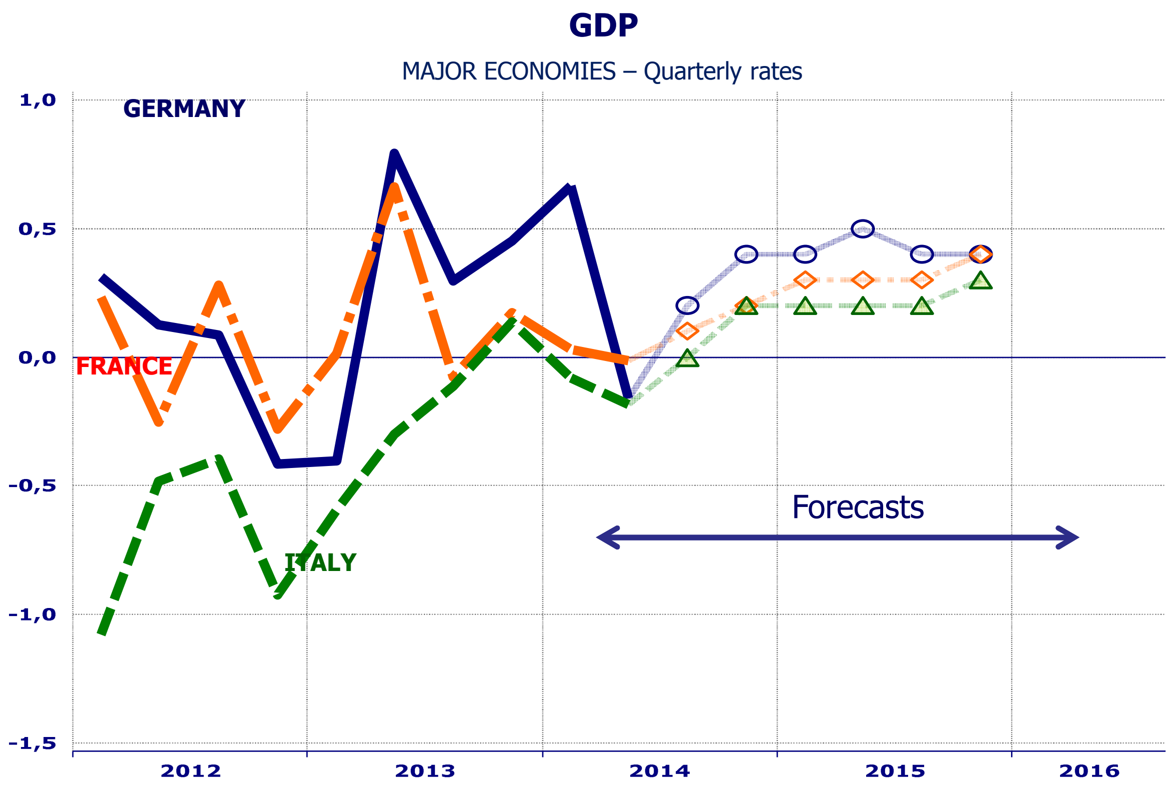
In the summer months, households' confidence partially deteriorated … the growth trajectory of the two indicators is signalling the first real decreasing inversion of the past two-year period…



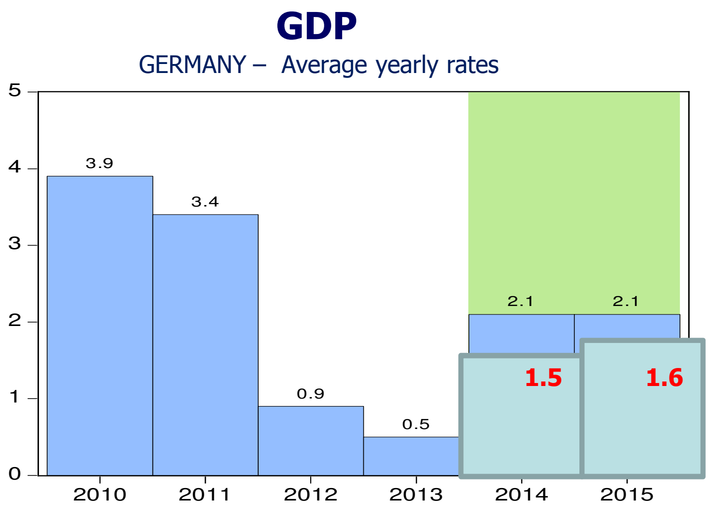


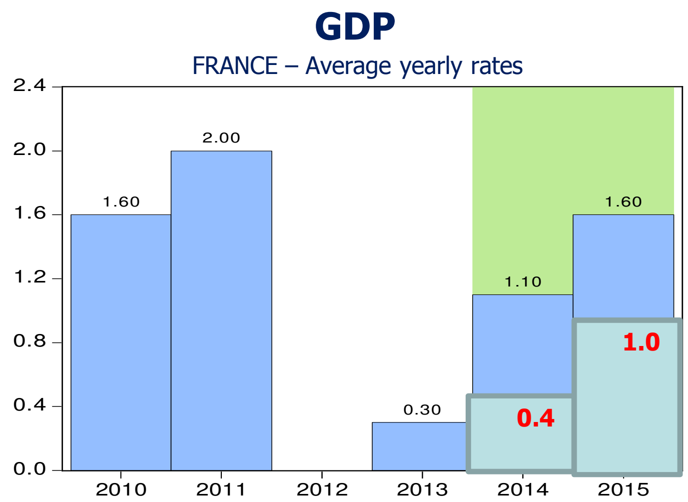
GROWTH FORECASTS

The basis for cuts in Eurozone's growth estimates lie in: 1) manufacturing's slowdown, with the sector's PMI indexes at last year's low in all major Eurozone economies, confirming a rapid decline in industrial confidence; 2) Germany's worsening economy; 3) Ukraine crisis. For Italy we expect a stagnation in Q3 and a new drop in income at the year's average (-0.2%); for France we assume a marginal progress in income between July and September (+0.1%) and a growth at 0.4%, around the year's average. Germany's forecast is for a mere 0.2% growth in Q3, under increasing risk, and an average annual growth at 1.5%.

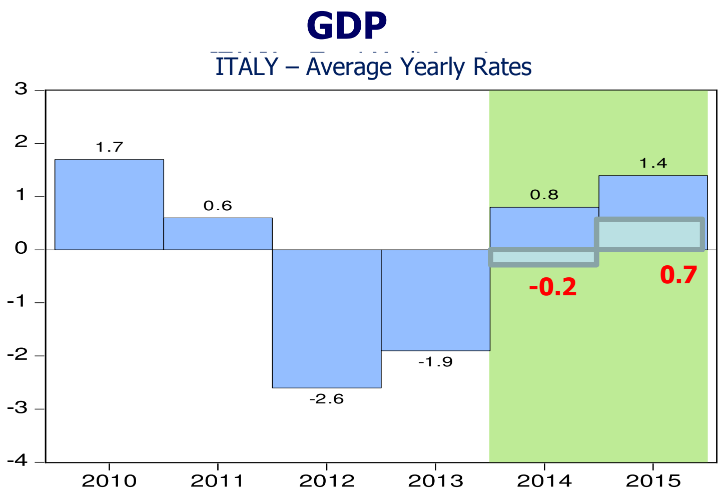


GROWTH FORECASTS





Comparison vs.
April estimates
(highest forecasts)

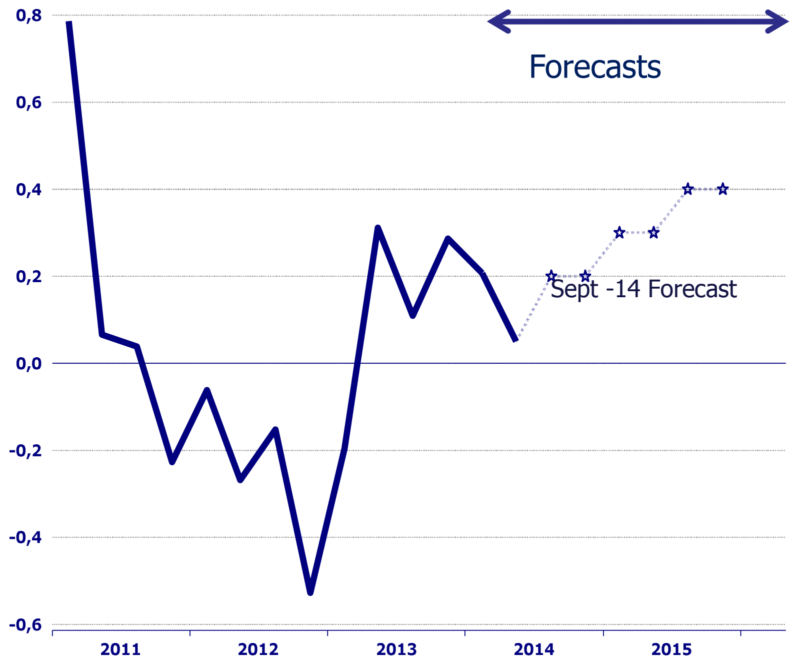


GROWTH FORECASTS

In Q3 we estimate an increase in Eurozone's aggregate income at 0.2%, down from previous 0.4% forecast. The average growth for 2014 will thus be under one percent (+0.8% from +1.0% in July, +1.4% in April). Expected growth for 2015 has been reduced to 1.1%, from 1.6% in July (+1.8% in April).

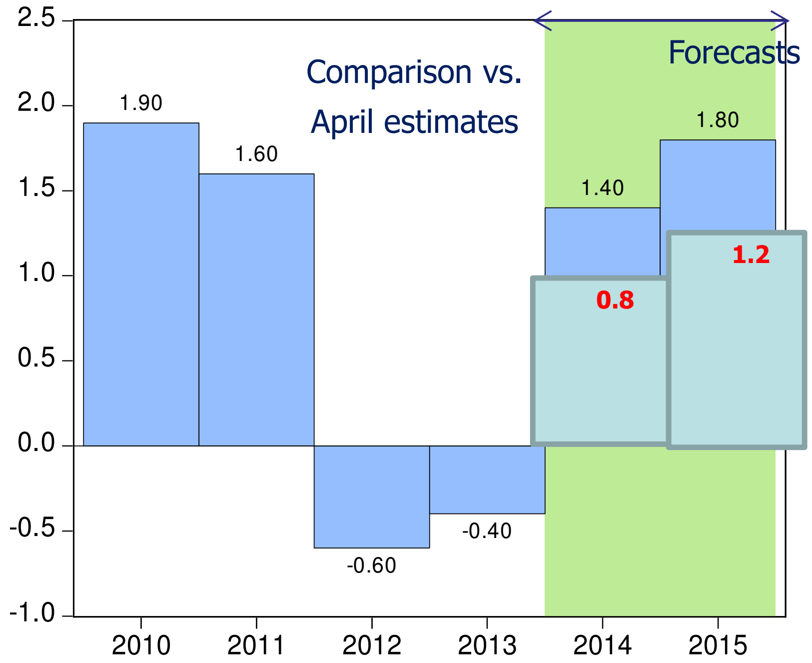
GDP

EUROZONE – Quarterly rates



GDP

EUROZONE – Average yearly rates

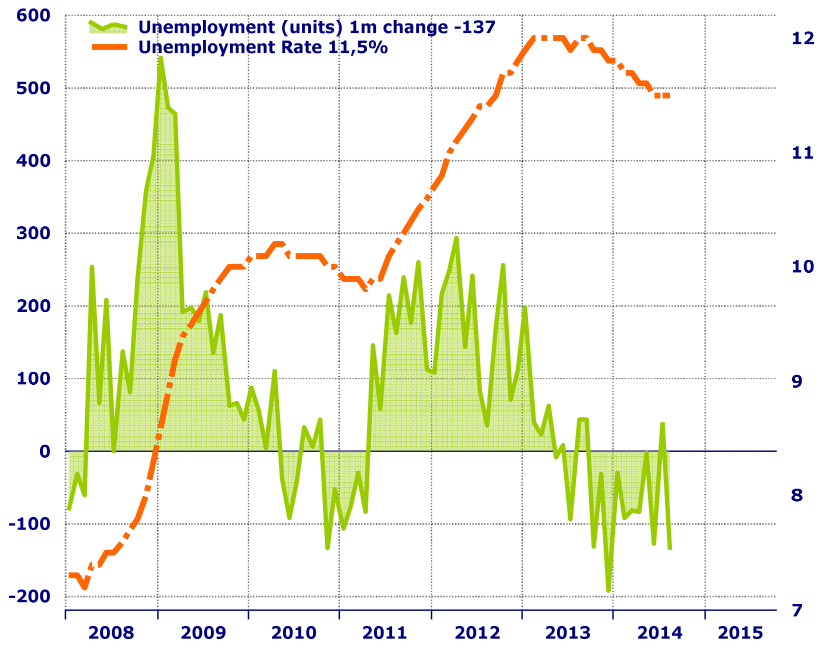


LABOUR MARKET

Employment in Europe remains complex. The labour market has passed its cyclical minimum and is improving on an aggregate level, with unemployment improving since its 2013 highs. However, the leading indicator weakened, increasing worries on sustainability in the long term.

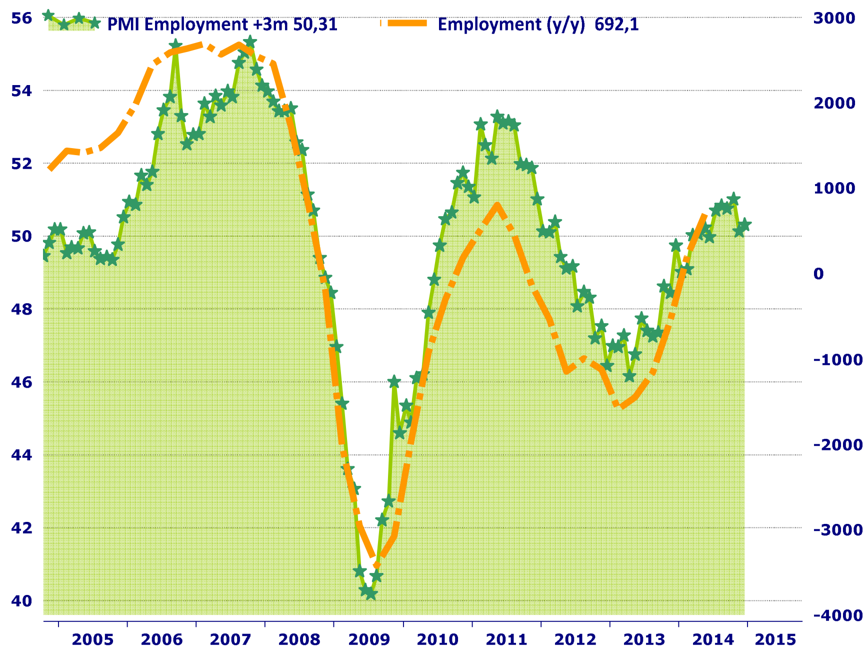
JOB MARKET

Unemployment



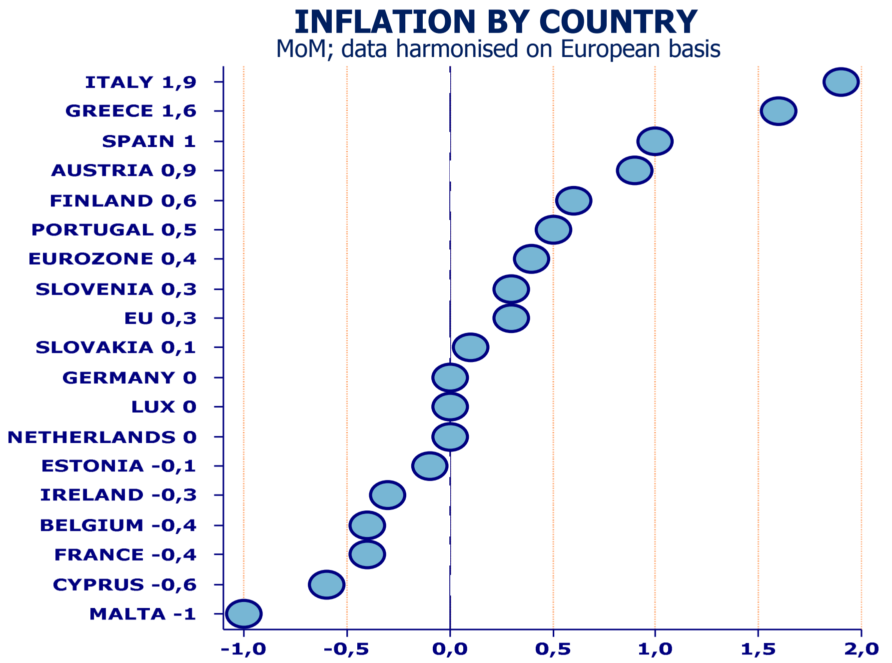
JOB MARKET

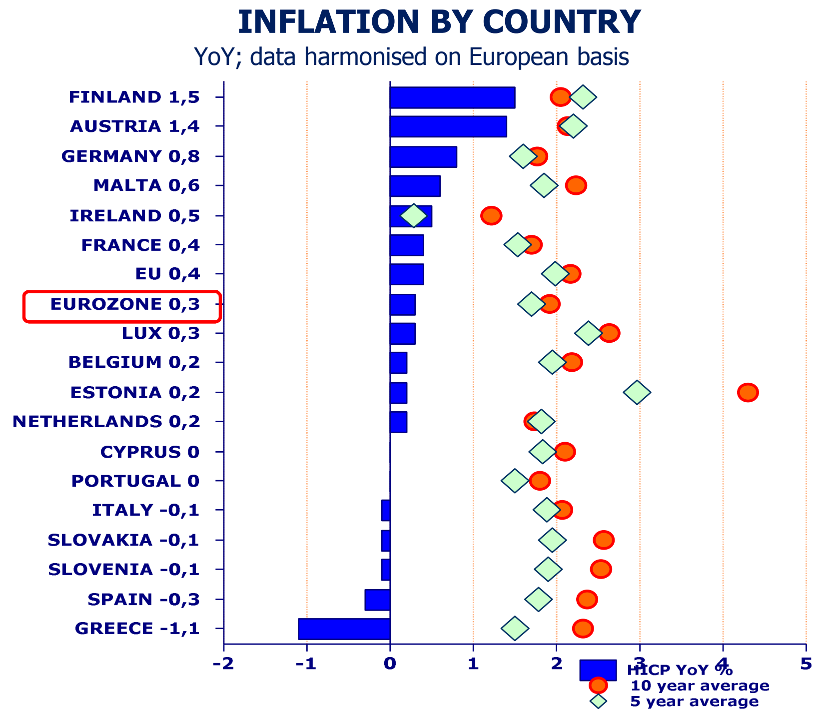
Employment and expectations



INFLATION

The most recent official photograph on inflation published by Eurostat is made by putting together September data. It shows that in that month Finland had the highest inflation in Eurozone (+1.5%), above Austria (1.4%), while Italy remains tied to countries with negative rates: Slovakia, Spain, Greece and Estonia. Portugal, who was negative, registered a null rate. Average inflation rate in the Monetary Union is at 0.3% in September.

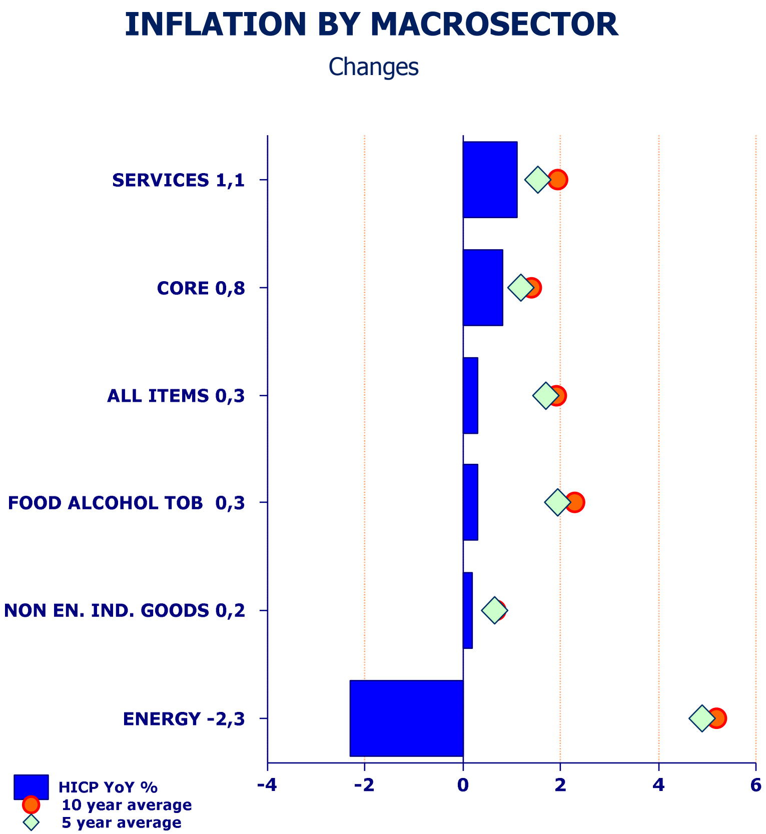


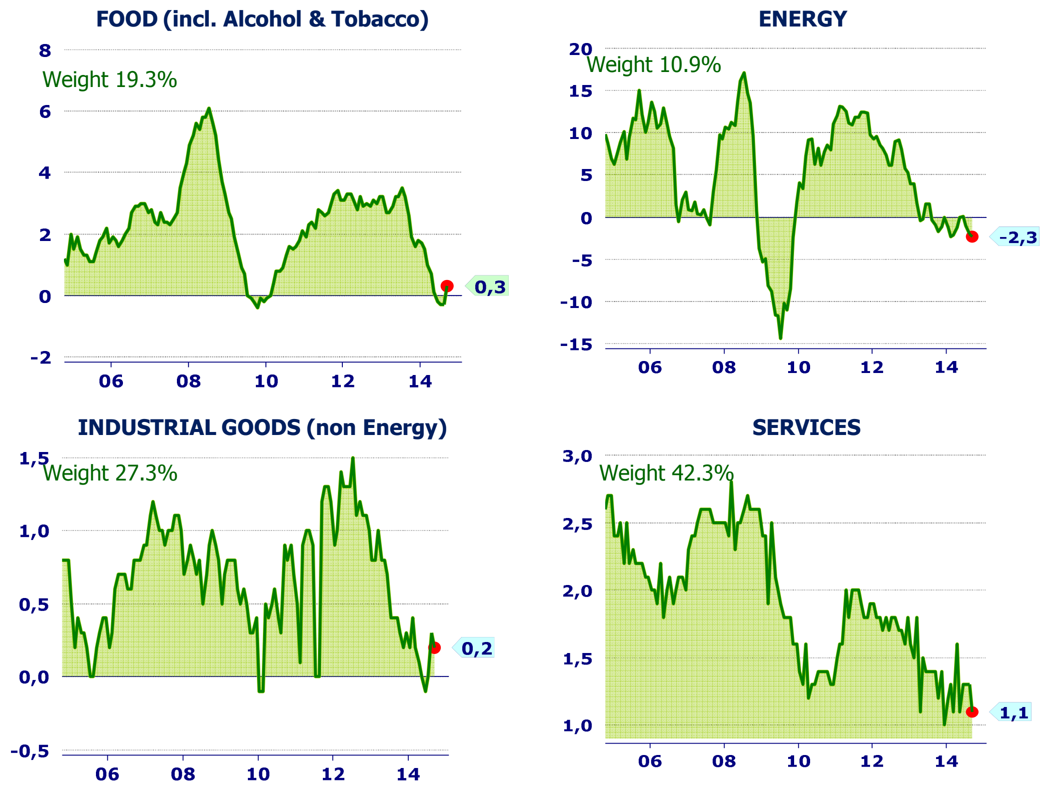


September '14 values

INFLATION

The energy component has a disinflationary role (-2.3% annually), but in September also the core components slowed down, in industry and services…Inflation on Food returned positive…

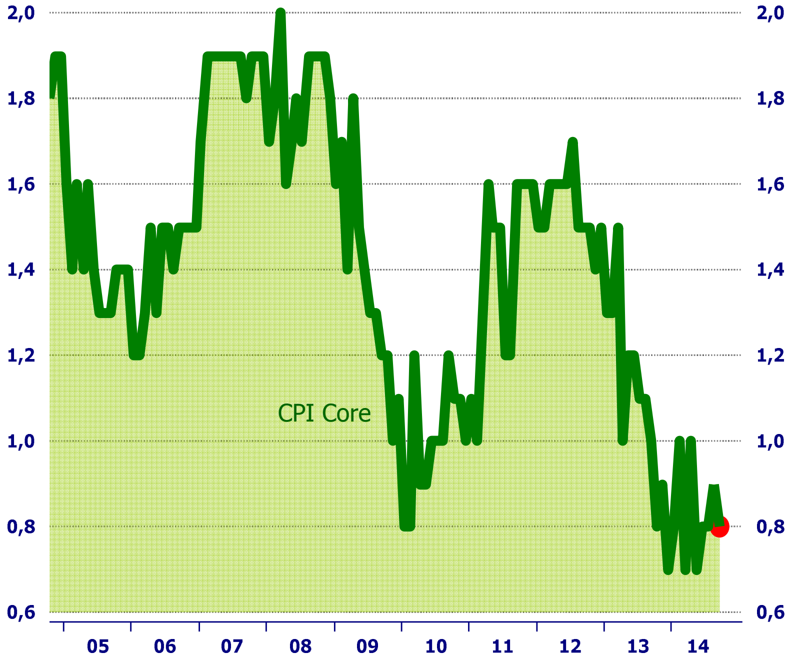




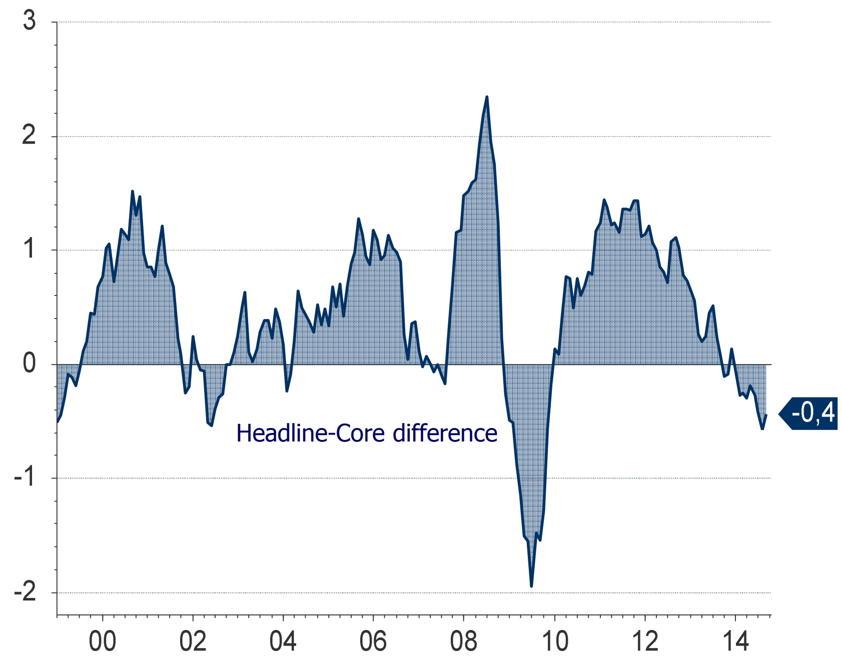
INFLATION

Core inflation continued to maintain a fluctuating behaviour, in the 0.7-1.0% range. The difference between the two main inflation measures is by four tenths in favour of core inflation, for the first time since 2010.

INFLATION
Changes

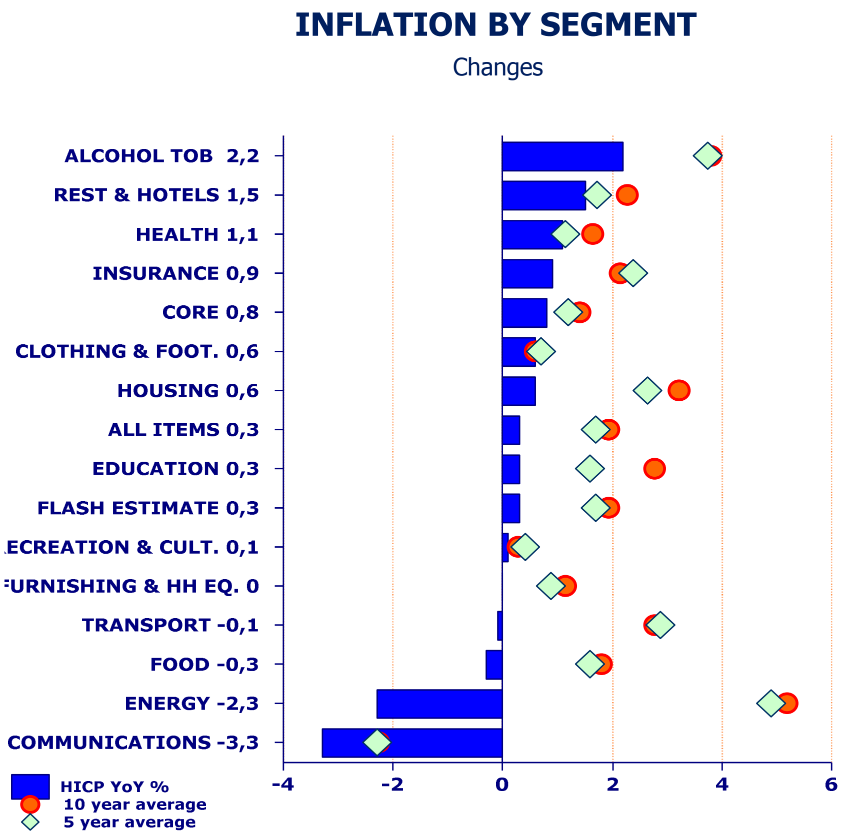


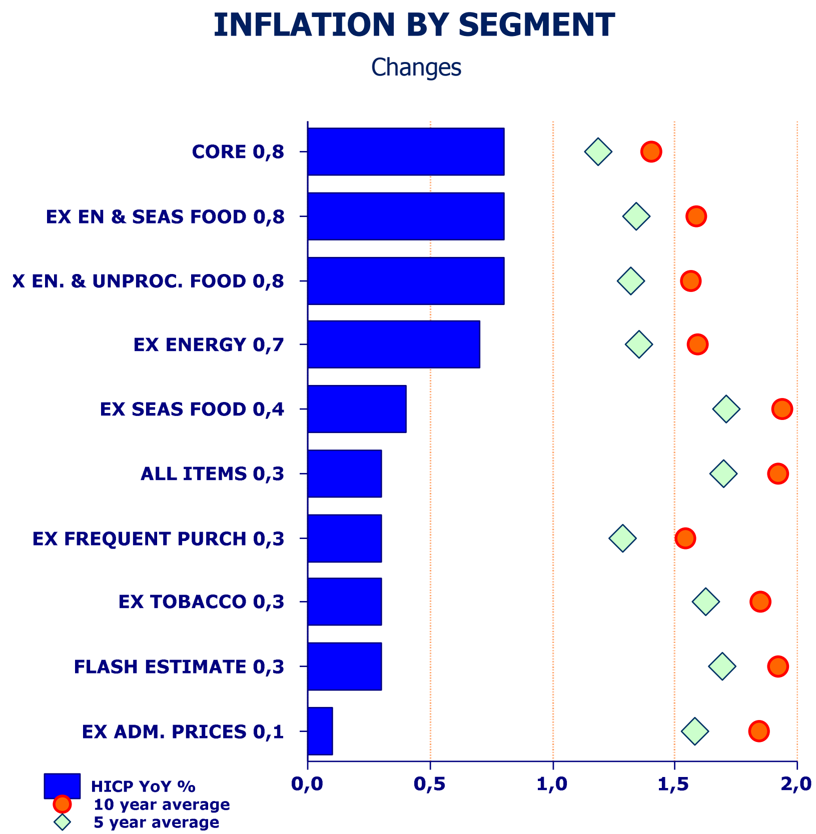
INFLATION
Changes



INFLATION

Core inflation remains higher... The lower measure is net of administered prices, at +0.1%...





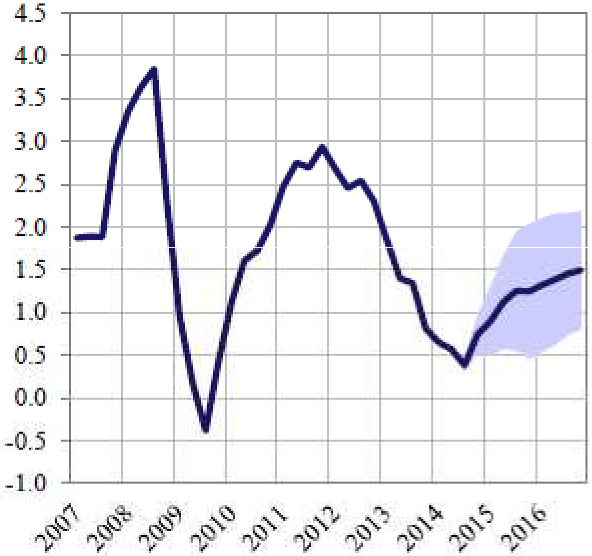
INFLATION - FORECASTS

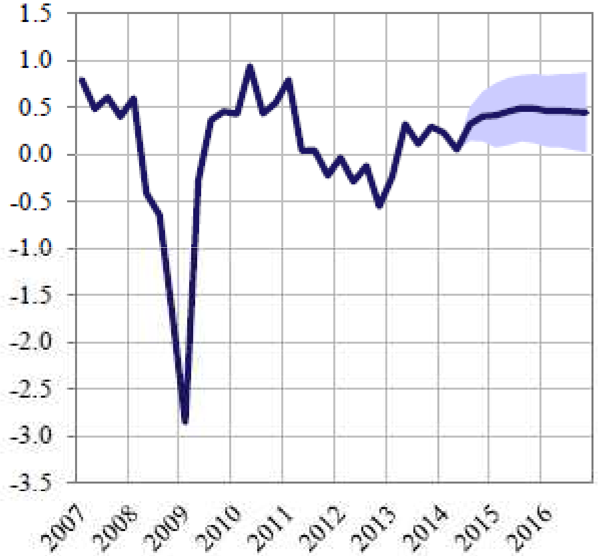
Inflation is bound to stay under 2% for the whole forecasting period. Starting in October, favourable base effects will tend to push prices on the rise. **Average rate at +0.6% in 2014, +1.0% in 2015.** Core inflation will fluctuate around an average 1%. **Average rate at +0.8% in 2014, +1.0% in 2015.** These values are under increasing downward risk, but we continue to exclude deflation in Eurozone.

ECB PROJECTIONS

Chart 1 Macroeconomic projections[1)]

(quarterly data)





1) The ranges shown around the central projections are based on the differences between actual outcomes and previous projections carried out over a number of years. The width of the ranges is twice the average absolute value of these differences. The method used for calculating the ranges, involving a correction for exceptional events, is documented in *New procedure for constructing Eurosystem and ECB staff projection ranges*, ECB, December 2009, available on the ECB's website.
2) Working day-adjusted data.

ECB PROJECTIONS

Table 2 Macroeconomic projections for the euro area[1]

(annual percentage changes)

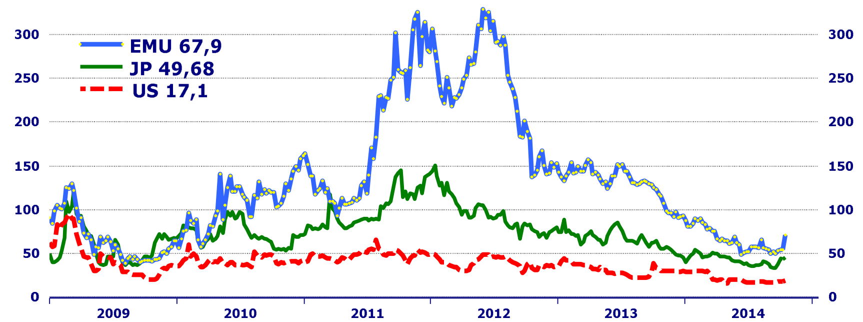
	September 2014				June 2014			Revisions since June 2014[2]		
	2013	2014	2015	2016	2014	2015	2016	2014	2015	2016
Real GDP[3]	-0.4	0.9	1.6	1.9	1.0	1.7	1.8	-0.2	-0.1	0.1
		[0.7 - 1.1][4]	[0.6 - 2.6][4]	[0.6 - 3.2][4]	[0.6 - 1.4][4]	[0.6 - 2.8][4]	[0.5 - 3.1][4]			
Private consumption	-0.6	0.7	1.4	1.6	0.7	1.5	1.6	0.0	-0.1	0.0
Government consumption	0.2	0.7	0.4	0.4	0.4	0.4	0.4	0.3	0.0	0.0
Gross fixed capital formation	-2.6	1.1	3.1	3.9	1.7	3.1	3.5	-0.6	0.0	0.4
Exports[5]	1.7	3.1	4.5	5.3	3.6	4.8	5.3	-0.5	-0.3	0.0
Imports[5]	0.7	3.5	4.5	5.3	3.6	4.8	5.5	-0.1	-0.4	-0.2
Employment	-0.8	0.3	0.6	0.7	0.3	0.5	0.7	0.0	0.1	0.0
Unemployment rate (percentage of labour force)	11.9	11.6	11.2	10.8	11.8	11.5	11.0	-0.2	-0.2	-0.3
HICP	1.4	0.6	1.1	1.4	0.7	1.1	1.4	-0.2	0.0	0.0
		[0.5 - 0.7][4]	[0.5 - 1.7][4]	[0.7 - 2.1][4]	[0.6 - 0.8][4]	[0.5 - 1.7][4]	[0.6 - 2.2][4]			
HICP excluding energy	1.4	0.8	1.3	1.6	1.0	1.3	1.6	-0.2	-0.1	0.0
HICP excluding energy and food	1.1	0.9	1.2	1.5	1.0	1.2	1.5	-0.1	0.0	-0.1
HICP excluding energy, food and changes in indirect taxes[6]	1.0	0.8	1.2	1.5	0.9	1.2	1.5	-0.1	0.0	-0.1
Unit labour costs	1.2	1.0	0.8	1.1	0.9	0.7	1.1	0.1	0.0	0.0
Compensation per employee	1.6	1.6	1.8	2.2	1.6	1.9	2.2	0.0	-0.1	0.1
Labour productivity	0.4	0.6	1.0	1.1	0.7	1.1	1.0	-0.1	-0.1	0.1
General government budget balance (percentage of GDP)	-3.0	-2.6	-2.4	-1.9	-2.5	-2.3	-1.9	-0.1	0.0	0.0
Structural budget balance (percentage of GDP)[7]	-2.2	-2.0	-2.0	-1.9	-2.0	-2.0	-1.9	0.0	0.0	0.0
General government gross debt (percentage of GDP)	92.7	93.9	93.1	91.5	93.4	92.6	91.1	0.5	0.5	0.4
Current account balance (percentage of GDP)	2.4	2.3	2.3	2.4	2.6	2.6	2.8	-0.3	-0.3	-0.4

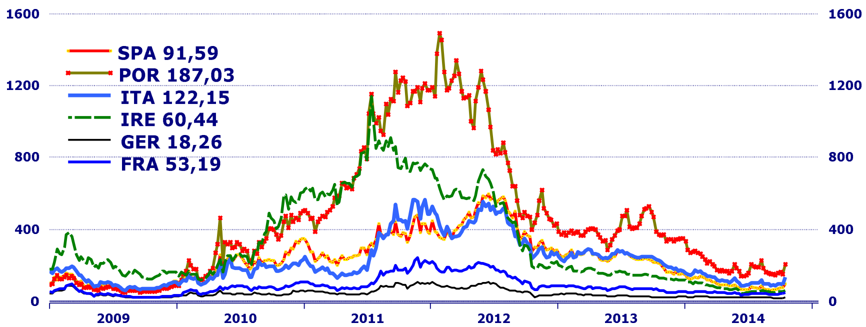
PUBLIC ACCOUNTS AND SOLVENCY

In Italy, out of the total 36 bn budget, 11.5 will be financed by deficit, balanced budget is delayed to 2017 and debt reduction rule is broken, as debt grows from 131.6% to 133.4%. The Commission will have to take into account the fact that the country is still in recession and that one of the reforms requested is awaiting approval (Jobs Act already passed at the Senate).

COUNTRY RISK – 5 YEAR CDS

5-year Credit default swap - Eurozone CDS based on Ger-Ita-Fra-Spa





Credit Default Swap 5Y, costo dell'assicurazione dal default del debitore.
Il valore pari ad. es. a 800, indica che per assicurare $10 milioni d'investimento occorre pagare un premio di $800.000

Fonte Bloomberg, rating aggiornati al 1/10/2014

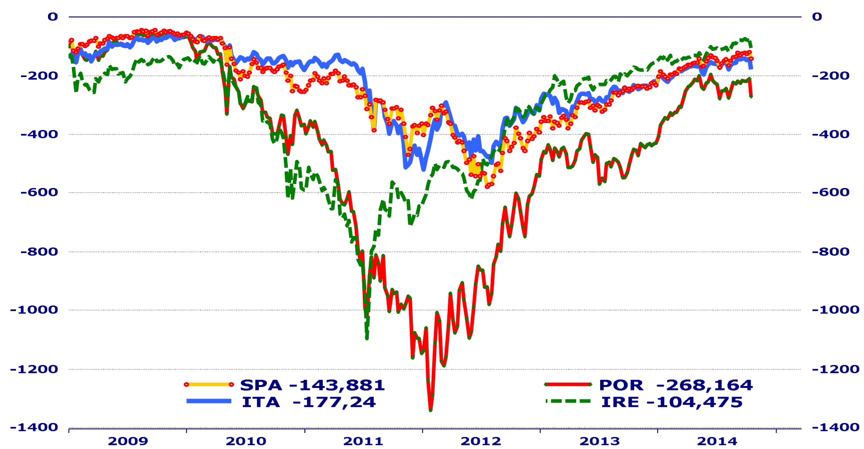
PUBLIC ACCOUNTS AND SOLVENCY

France has done even more, risking litigation with the Commission, after signalling in its budget that in 2015 deficit will decrease fractionally, at 4.2% from this year's 4.3%, and that it will return below 3% in 2017. Structural balance will diminish only by two tenths next year (from -2.4% to -2.2%), while public debt will grow further until 2016.

Greece has tried in vain to exit in advance from its Economic Adjustment Programme (markets and Europe expressed a negative response), while the improving global trend in rating was interrupted in October with S&P's downgrading Finland, at AA+ down from triple A.

COUNTRY RISK AND RATING

10-year rates differentials with Germany in basis points

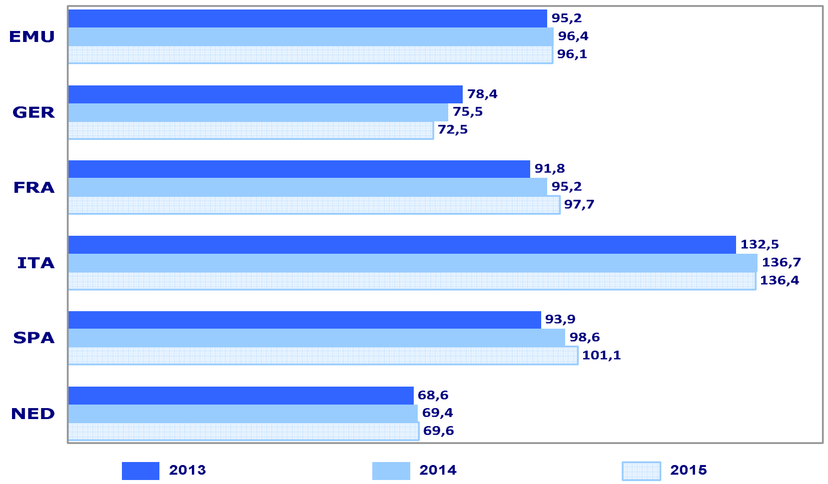


	Moody's	S&P	Fitch
Francia	Aa1	AA	AAA
Germania	Aaa	AAA	AAA
Grecia	Caa3	B-	B
Irlanda	Baa3	BBB+	BBB+
Italia	Baa2	BBB	BBB+
Portagallo	Ba1	BB	BB+
Spagna	Baa2	BBB	BBB+
Giappone	Aa3	AA-	AA-
Stati Uniti	Aaa	AA+	AAA

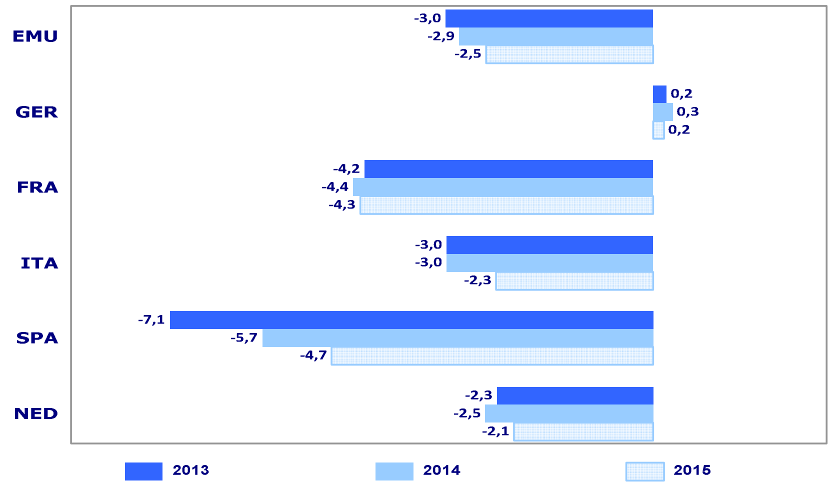
Fonte Bloomberg, rating aggiornati al 1/10/2014

IMF – FISCAL MONITOR

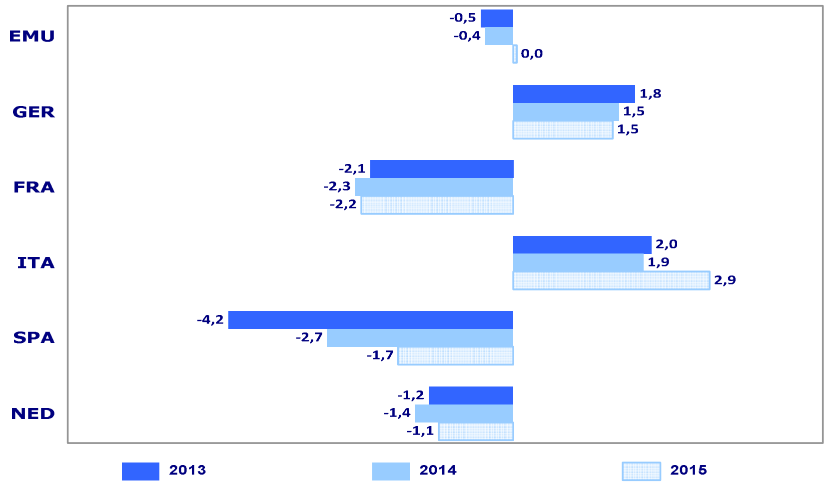
DEBT/GDP estimates 2013-2015



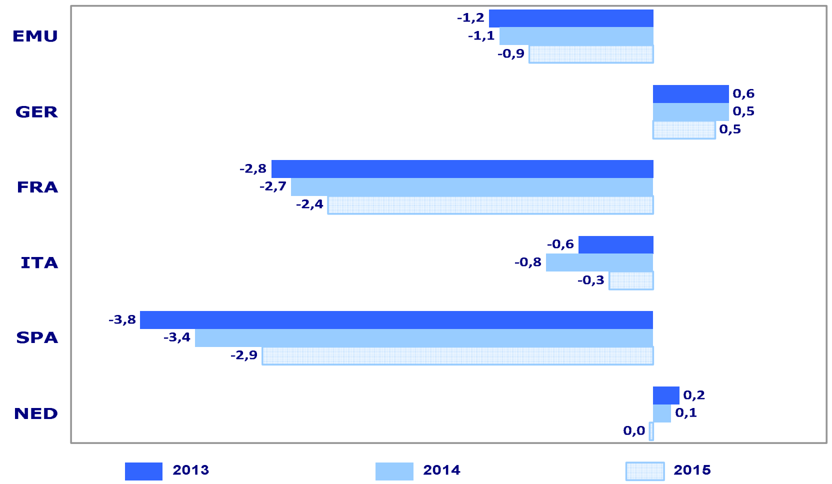
DEBT-SURPLUS/GDP estimates 2013-2015



SURPLUS-PRIMARY DEFICIT/GDP estimates 2013-



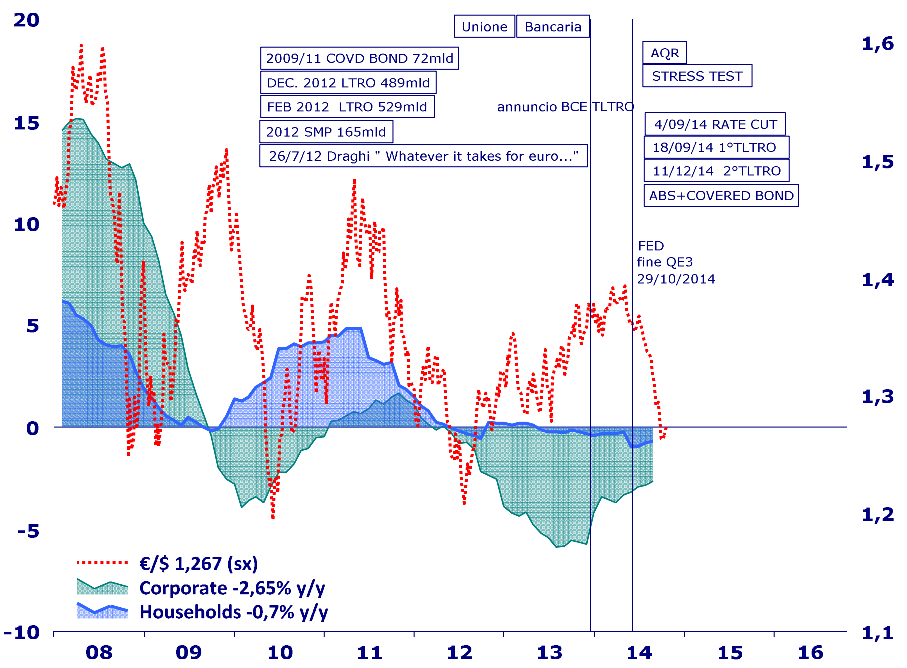
STRUCTURAL BALANCE



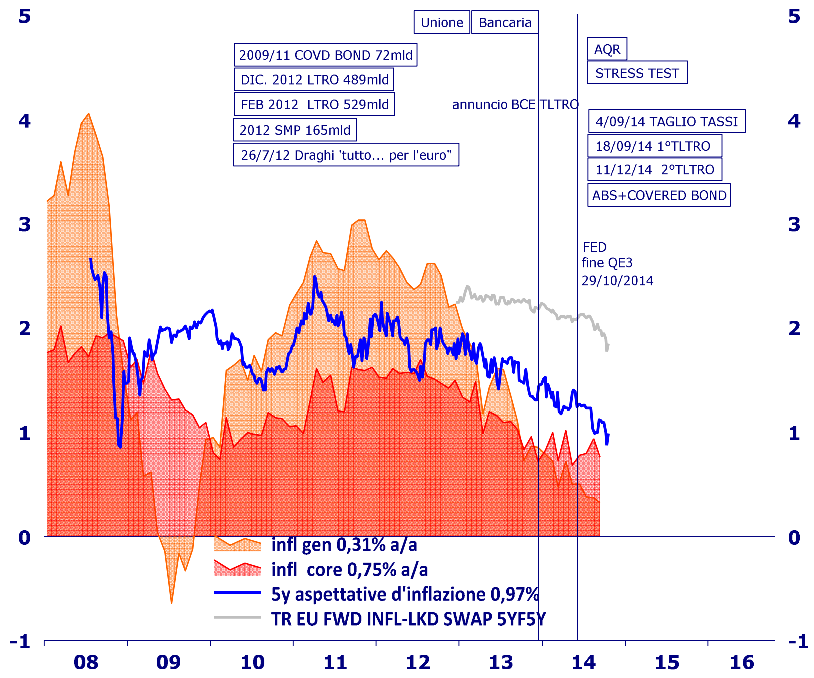
MONETARY POLICY

ECB has begun part of the *credit easing* plan, financing the system on the long term under certain conditions. The first round of the *tltro* was disappointing (only 82 bn out of the over 100 forecasted). However, the second one, scheduled for 11 December will define the general scope. The acquisition of *covered bank bonds* will begin this month, while *abs* will start in January.

CREDIT, EURO AND ECB



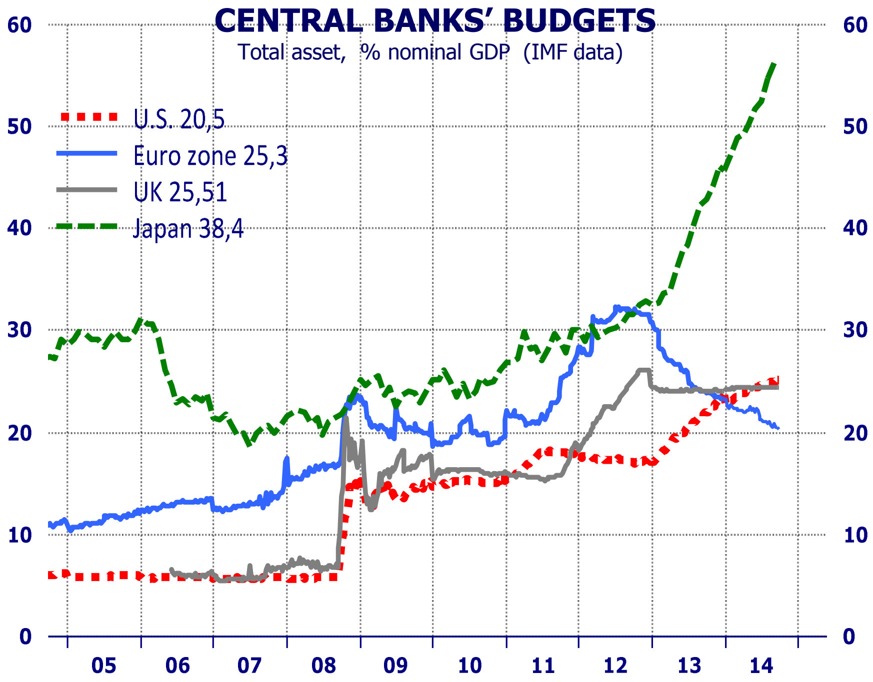
INFLATION, EXPECTATIONS AND ECB

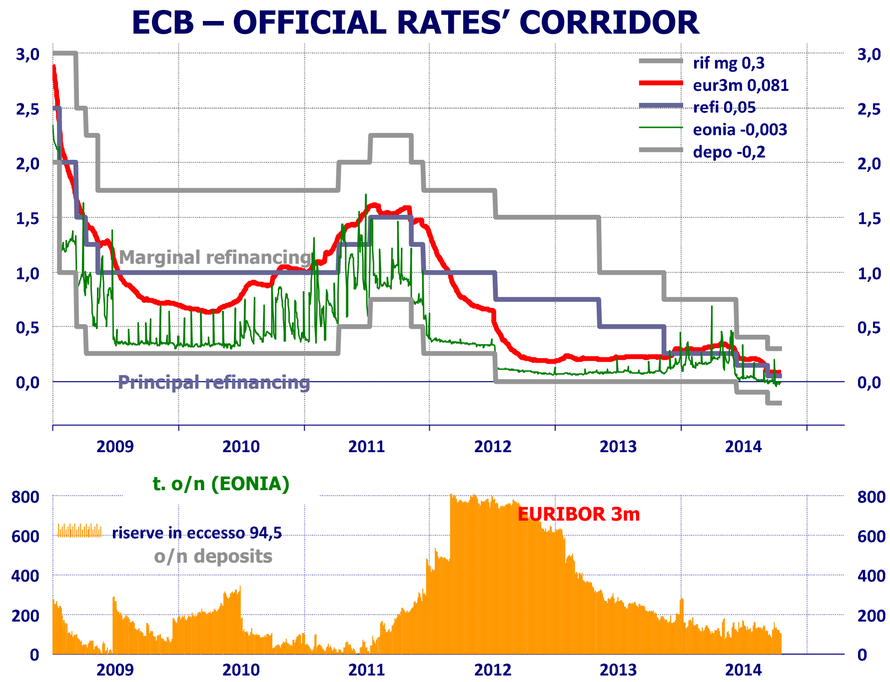


MONETARY POLICY

ECB will buy only *senior* and *mezzanine tranche* (with government warranty), thus not freeing space in banks' budgets for new commitments. For that to happen they should also buy *junior tranche* (higher risk/earnings profile).

Additional measures could be taken next year in case of a further deterioration in long term inflation expectations.





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